Dividend Dashboard

AJBell Youinvest

Can you rely on FTSE 100 companies to pay dividends?

This report shows: How to spot unsustainable dividends | How consistent dividend growth drives stellar investment returns

Looking beyond the headline dividend yield of a stock

Reinvested dividends have accounted for 65% of total returns from the FTSE All Share over the past 30 years. It is therefore tempting to look for stocks that might pay the highest dividends.

However, some of the juiciest-looking forecast dividend yields could just prove too good to be true – which is why investors should also look carefully at 'dividend cover', i.e. how many times a company's profit covers its dividend pay-out.

Each quarter, AJ Bell takes the forecasts for the FTSE 100 companies from all the leading city analysts and aggregates them to provide the dividend outlook for each company. The data below relates to the outlook for 2016.

How is dividend cover calculated?

Dividend cover is the amount of profit a firm makes, divided by the dividend it pays out to shareholders.

The table below shows the dividend cover for a company making a profit of £100 and paying three different levels of dividend:

Dividend	Calculation	Dividend cover
£50	£100 divided by £50	2
£100	£100 divided by £100	1
£150	£100 divided by £150	0.67

What is the impact of dividend cover?

1

Divided cover of below 1 should ring alarm bells because it means the company is paying out more to shareholders than it makes in that year, which means it has to dip into cash reserves or borrow money to maintain the payment. This is unlikely to be sustainable over the long term.

1.5

Dividend cover of around 1.5 is less than ideal because it means a company has less room for manoeuvre if profits fall in one year. It will then need to decide whether to reduce its dividend or stop reinvesting in the business.

2

Dividend cover of 2 or above is ideal because it means profit is double the amount the company is paying out to shareholders. This means it can continue to invest in the business and has scope to maintain its dividend payment in a bad year.

FTSE 100 dividend danger zone

The ten stocks forecast to pay the highest dividend yield in 2016 all have forecast dividend cover below 2:

	Forecast dividend yield for 2016	Forecast earnings cover for 2016
Direct Line	8.0%	1.02x
Royal Dutch Shell	7.5%	0.52x
Taylor Wimpey	7.4%	1.52x
BP	7.0%	0.43x
Legal and General	6.7%	1.46x
Marks & Spencer	6.6%	1.45x
Pearson	6.5%	1.08x
Persimmon	6.2%	1.71x
Admiral Group	5.9%	1.71x
SSE	5.9%	1.31x
Average		**1.22 x**

Seven FTSE 100 firms are forecast to have dividend cover of less than 1:

	Forecast dividend yield for 2016	Forecast earnings cover for 2016
St. James's Place	3.3%	0.99x
Admiral Group	5.9%	0.90x
BHP Billiton	2.1%	0.70x
Vodafone	5.5%	0.56x
Royal Dutch Shell	7.5%	0.52x
BP	7.0%	0.43x

An additional 20 FTSE 100 firms are forecast to have dividend cover of less than 1.5:

	Forecast dividend yield for 2016	Forecast earnings cover for 2016
AstraZeneca	4.2%	1.49x
British American Tobacco	3.5%	1.48x
Legal and General	6.7%	1.46x
National Grid	4.2%	1.45x
Marks & Spencer	6.6%	1.45x
Unilever	2.9%	1.39x
Standard Life	5.8%	1.32x
Provident Financial	4.3%	1.32x
SSE	5.9%	1.31x
Severn Trent	3.3%	1.28x
Centrica	5.4%	1.25x
British Land	4.6%	1.25x
HSBC	5.8%	1.22x
Hammerson	4.2%	1.22x
Land Securities	3.6%	1.20x
GlaxoSmithKline	5.0%	1.17x
United Utilities	4.1%	1.13x
Pearson	6.5%	1.08x
INTU	5.0%	1.05x
Direct Line	8.0%	1.02x

Dynamic Dividends

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Consistent dividend growth drives stellar investment returns

The importance of sustainable dividends, rather than simply the highest possible yield, can be illustrated by looking at the firms that have track records of dividend growth. The table below shows the 25 current members of the FTSE 100 that have increased their dividend in each and every year over the past decade.

Not only have these firms consistently increased their pay-outs to shareholders, the effect on the capital return from their share price has been startling in many cases.

- Back in 2006, the 25 names were offering an average dividend yield of 2.8% between them. However, if investors had bought those stocks and still held them today they would be providing an average 9% yield.
- The average share price gain from those 25 firms was 247% since 1 January 2016 – compared to a 9% advance in the FTSE 100 over the same time period.

Russ Mould, investment director at AJ Bell, comments:

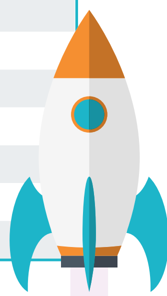
“These trends highlight an important consideration for retail investors. It is consistent dividend growth, underpinned by earnings and profit that drives shareholder returns.

“It is therefore important to check the degree to which earnings and cashflow cover the forecast dividend payments and to make sure a company is not having to strain to keep its run going.

“Diverting cash to fund the distribution and away from investing in the day-to-day business could weaken a company’s long-term competitive position – and it is strength here that ultimately provides the pricing power which in turn provides the consistent cashflow that makes the payments possible.”

The value of your investments can go down as well as up and you may get back less than you originally invested. We don’t offer advice, so it’s important you understand the risks, if you’re unsure please consult a suitably qualified financial adviser. Past performance is not a guide to future performance and some investments need to be held for the long term. *Data correct as at 28 September 2016.*

	Share price performance 2006-15	Dividend CAGR 2006-15
Micro Focus International	1651.4%	25.1%
Paddy Power Betfair	766.4%	21.4%
Ashtead	749.5%	26.9%
Shire	479.2%	16.3%
Compass	448.1%	11.3%
DCC	411.3%	11.3%
Hikma Pharmaceutical	398.6%	43.1%
Intertek	341.2%	13.5%
Babcock International	250.9%	16.1%
Bunzl	241.5%	8.4%
British American Tobacco	239.2%	10.7%
InterContinental Hotels	225.1%	12.2%
Associated British Foods	213.1%	6.9%
Whitbread	194.4%	11.6%
Sage	189.9%	13.8%
St. James's Place	166.4%	22.4%
Imperial Brands	156.9%	10.1%
Next	150.4%	13.6%
Johnson Matthey	135.0%	8.0%
Diageo	134.8%	6.1%
Prudential	105.0%	8.5%
Vodafone	76.5%	5.4%
Capita	74.3%	13.4%
Sky	55.2%	10.4%
BAE Systems	31.6%	6.3%
SSE	16.8%	5.0%
Pearson	-1.4%	5.9%
Average	**292.6%**	
FTSE 100	**14.2%**	



Investors looking for high yielding stocks that could be sustainable over the long term, might want to focus on the companies that offer the highest forecast dividend yield but are also forecast to generate earnings that are more than twice their dividend payments:

The stocks forecast to offer the highest dividend yield in 2016 with dividend cover of over 2 x earnings:

	Forecast yield for 2016	Forecast earnings cover for 2016
Lloyds	5.6%	2.30x
International Cons. Airlines	5.5%	4.01x
easyJet	4.9%	2.04x
Barratt Developments	3.8%	3.01x
ITV	3.8%	2.28x
Next	3.7%	2.32x
Old Mutual	3.5%	2.60x
Capita	3.4%	2.20x
3i	3.2%	4.66x
Polymetal	3.1%	2.56x